ASSESSMENT OF THE NEW WEALTH STATEMENTS SYSTEM OF THE POLITICALLY EXPOSED PERSONS (PEP's)

LEGISLATED IN CYPRUS IN 2024

Introduction

In 2024, both the law regulating the "Wealth Statements" of the President of the Republic, his Ministers and the Members of the Cyprus Parliament, as well as the law regulating the "Wealth Statements" of the senior civil servants were repealed and replaced by two new pieces of legislation, in which numerous suggestions of ours (advanced in our previous assessment of the system) were adopted. However, some serious gaps and contradictions were retained. As a consequence, the system remains inoperable and inefficient.

In the two new laws, the information, which must be set out in these declarations, is specified in a table annexed to the law. Part A of this table prescribes the individual assets and liabilities which must be declared by the politically exposed person, his/her spouse and their dependents, but the publicly disclosed assets, liabilities, income and expenses are only those of the politically exposed person, while the assets of his/her spouse and their dependents only need to be disclosed as the total net amount of these assets, without any other information or explanation. For example, if the total assets of the spouse and the dependents amount to €2 million and the corresponding liabilities amount to €1.9 million, the amount that needs to be disclosed as corresponding to the net assets of the spouse and the dependents will be confined to €100 thousand.

In this note we highlight the main weaknesses of the new system, which, in our opinion, will lead to the future failure of the system.

The aforementioned two new laws, as published in the Official Gazette of the Republic of Cyprus, are set out as "appendices". It should be noted that the text has been rendered into English (from the original in Greek) by utilising Microsoft's machine translator, without any intervention on our part. It follows that we do not provide any assurance for the accuracy and completeness of the translation and we disclaim any liability in this regard.

The "Statements of Wealth" is a mathematical equation

The most serious problem that arises from the study of the 2 new laws passed in 2024 is the apparent ignorance (on the part of the authors of the new legislation) of the essence of the "Statements of Wealth". The "Statements of Wealth" is an accounting tool for the detection of undeclared revenues and, in particular, the proceeds derived from illegal or questionable acts. In essence, the tool is based on the following simple mathematical equation:

Net assets (assets minus liabilities), at the beginning of a period
minus net assets, at the end of the period (at cost)
is equal to the income declared in that period
minus the living expenses incurred in the same period

Concealing illicit income and the corresponding assets

Obviously, the most qualified person to quantify the individual elements of a declaration of assets and liabilities is the person compiling the declaration. If an income item is incorrect or has been omitted altogether, then the equation is frustrated, i.e. some other individual elements of the declaration must be corrected (or manipulated) in order to validate the equation. For example, if the amount of a bribe received is omitted from the declaration, the asset resulting from the receipt of the bribe must also be omitted. It is obvious that the task of identifying and disclosing undeclared income is a particularly difficult one, given that the corresponding asset can easily be hidden in an offshore company or trust. The fact of concealment is, of course, known to the recipient of the bribe and, usually, to his/her accountant and their close associates, who have every reason to want to conceal the illegal act, since its disclosure will make them accomplices to the

offence that has been committed. It follows that the provision embedded into the 2 new laws of 2024, which requires "*a written affidavit under oath, setting out the specific facts and/or the evidence ... substantiating the allegations*" of the person alleging the existence of illegal or questionable acts and the need to demonstrate the absence of any reason that should have led him/her to conclude that his/her allegations contain inaccuracies is certain to serve as a barrier discouraging the disclosure of such acts, especially in view of the fact that the failure to prove the accuracy of the allegations will render the person making the allegations guilty of a criminal offence, punishable by a fine of €50,000 or by a sentence of 3 years imprisonment or both. Under these conditions, the securing of such an affidavit is a remote possibility.

The absurdity of this provision is highlighted by contrasting the above provision with the penalty stipulated by law in the event that the politically exposed person is found (in the context of a "Special Investigation") guilty of having filed a false declaration. The person found guilty of such an offence is liable to a fine not exceeding €10.000 (€5.000 in the case of the senior civil servants) or imprisonment not exceeding 1 year and/or to both of these penalties.

It may be worth mentioning that in our original *"White Paper*", we proposed the confiscation of the undeclared assets and the imposition on the undeclared income of all the prescribed taxes and appropriate punitive surcharges and fines. In our opinion, imprisonment does not constitute a sufficient deterrent for those involved in economic crimes, while it burdens society with the significant costs of accommodating, feeding and guarding the offenders.

Pursuing the goal of combating corruption and collusion by those involved in these acts is a utopian objective

An equally serious problem, arising from the study of the 2 new laws passed in 2024, is the "self-service" approach adopted in respect of the monitoring and control of filed returns, given that this difficult task, which requires technical knowledge and independence of the "assessor" from the "assessed", has been assigned, by the law itself, to a three-member committee consisting of the President and 2 Members of the House of Representatives. In fact, the law also recognises the possibility of the prescribed "Special Investigation" being undertaken in respect of the President and the Members of the "Special Committee", the Members of the Cabinet and the President of the Republic himself.

In the event that it transpires from a Special Committee report that a PEP has included in the Statement of Assets and Liabilities, the Statement of Income and Expenditure or the Reconciliation Statement filed, "one or more items the source of which is not justified" or that the "changes in the reported net assets is not supported by adequate explanations", then (and only then) the findings are directly transmitted to the Attorney General of the Republic by the "Special Committee" itself. It is noteworthy that the Attorney General of Cyprus has the power to close a criminal case, "on the grounds of the public interest", without having the obligation to justify his decision (nolle prosequi).

Also noteworthy is the legislative provision which provides that "in case the above findings concern the Attorney General of the Republic himself, then they are transmitted to the Assistant Attorney General of the Republic". In effect, the subordinate is called upon to judge his superior.

What is meant by the legislative reference to the possibility of changes in the reported items of wealth "not being sufficiently justified or not being justified at all"?'

In our opinion, the above reference indicates an insufficient understanding of how the "Statements of Wealth" tool works, given that the anticipated "Reconciliation Statement" (i.e. the verification of the equation) is only possible on an aggregate basis and it cannot even be attempted in relation to individual wealth items. Simply put, it is not possible to conceptually link an increase or decrease of a particular asset to a particular source of income or to a specific expense. This lack of understanding was also a key problem encountered in the repealed legislation which, unfortunately, persists.

The involvement of the Commissioner of Taxation in the fight against corruption and collusion

The two newly introduced pieces of legislation on the "Statements of Wealth" assign a leading role to the Commissioner of Taxation, in the process of detecting illegal acts, such as bribery. Undoubtedly, the collective experience and knowledge of the Tax Department of the Ministry of Finance is sufficient for this purpose. However, it is well known that the Tax Department is encountering serious difficulties in meeting its basic mission, which is the imposition and collection of taxes and, more generally, the fight against tax evasion. The Tax Department is already overloaded with a large and difficult task. The consequence of this overloading is the observed long delays in the examination of the submitted tax returns, but also the examination of the submitted objections against arbitrary tax assessments. The delays experienced are often longer than three years. The addition of literally thousands of "Wealth Statement" declarations to the workload of the Tax Department will have the consequence of either a failure to examine properly the "Statement of Wealth" declarations or the improper examination of tax returns.

Moreover, in our opinion, there is a further serious problem in the involvement of the Commissioner of Taxation in the “Statements of Wealth” process. This is the problem of the lack of the necessary independence from those subjected to the investigation. The employees of the Tax Department, including the Commissioner himself, are civil servants, whose advancement depends on the politically exposed persons that are the subjects of the “Statements of Wealth” investigations. The possible adverse consequences of that relationship are readily apparent. We believe that only a completely independent Authority, with powers to prosecute, could effectively carry out the task of managing and supervising the "Statements of Wealth" of the politically exposed persons and the senior executives of the public administration.

The 'value' and the ‘cost of acquisition’ of an asset are two entirely different things

On repeated occasions, we have emphasised that the "Pothen Esches" (“where has your wealth been derived from”) tool is based on the "acquisition cost" of an asset and has absolutely nothing to do with its current market value. For example, an asset can be a piece of land that has been inherited, i.e. acquired without paying any monetary consideration and without incurring any other costs. This is often the case in Cyprus where no tax is imposed on gifts and inheritances. It follows that the determination and listing of the "market value" of any asset held – a subjective and difficult task – serves no purpose whatsoever and "blurs" the landscape, undermining the effort to combat corruption and collusion, by causing confusion and unnecessary complications. Of course, if a painting with a market value of €2 million is presented in a minister's statement of wealth as having been acquired "by way of a gift", it is a matter that clearly needs to be investigated and for this reason it must be adequately described and depicted at a nominal value of €1. The same comments apply in the case of high-value jewellery, which is sometimes given to politicians and senior civil servants to secure a preferential treatment. It is obviously naïve to expect that the object of the bribe will be depicted, in the beneficiary’s "Statement of Wealth", at its real market value, at the time of the transfer of the ownership of the asset, from the provider of the inducement to the recipient of the inducement. The goal, therefore, should be limited to the minimum, which is simply to reveal the acquisition of the painting or the jewellery and the fact and that it has been acquired by the politically exposed person or his/her spouse or dependents "by way of a gift" (for the nominal consideration of €1).

It is true that in the preamble to the laws it is explicitly stated that the declared property is presented at "cost prices", but in the law governing the wealth of the senior civil servants (in Article 4 concerning the content of the declaration), the phrase "value in the year of acquisition of each specific asset” has managed to creep in. This slip-up will inevitably give rise to problems of interpretation.

Apart from the "cover-up", what is the point of not disclosing the assets of the spouse and of the dependent persons?

A major step forward (compared to the previous legislation) was the confirmation that the restriction of the right of protection of personal data is permissible, for reasons of public interest, in the case of any person in public office or managing public funds or playing a role in public political and economic life, since it promotes transparency and serves the overriding objective of combating corruption in public life. The entire preamble to the newly enacted legislation justifies the need to disclose the personal and professional wealth of the politically exposed persons and admittedly achieves its objective in an ideal fashion. The failure of past legislation to explain the need to curtail the protection of personal data in these cases was the sole reason why a similar provision in the repealed legislation was previously declared unconstitutional.

However, this achievement has been largely negated by the legislator's stand that this need does not extend to the spouse and the dependents of the politically exposed person. The consequences of this omission are aggravated by the ease and speed with which the transfer of assets by way of a gift, from one natural person to another, is realised in Cyprus, but also by the absence of any Cyprus tax or fee on the transfer. It is also known that in Cyprus – with the possible exception of inherited property – assets acquired after marriage generally constitute wealth jointly owned by the spouses. A good example is the “joint bank accounts”, out of which family expenses and family investments are covered. It may be appropriate to note that Cypriot family law also recognises the joint ownership of property acquired after marriage or after entering into a civil partnership. Of course, this reference does not relate to the case of divorced or separated persons.

Under these circumstances, the separation of the family wealth into the wealth of each family member will prove arbitrary and - in many cases - practically impossible. It is clearly impossible to share family expenses and this has been acknowledged by the legislator, who explicitly states in the Annex (where the contents of the Wealth Statement return are specified) that with regard to expenses the "separation between spouses is not necessary", thus nullifying the practical value of the tool, by making part of the equation of the "Statements of Wealth" inaccessible by the civil society.

Companies and trusts have been placed outside the scope of the "Wealth Statements".

Another serious problem of the new legislation is the fact that both companies (even those that are wholly family-controlled) and trusts have been placed outside the scope of the reportable assets, since these elements (for example, the shares of an investee company) are reflected at their acquisition cost and their link to the “Wealth Statements” is confined to any "distributed dividends".

It follows that by setting up an offshore company established in a tax haven, it is fairly easy to accumulate illicit revenues, which will be effectively disguised, at least for as long as the politically exposed person retains that status and has the obligation to draw up and file Statements of Wealth. This observation is of particular relevance, in view of the limitation of the length of posting the declared information to 12 months and the obligation to destroy the returns five years after filing.

There is no doubt that the provision of law prohibiting the disclosure of home addresses, bank account numbers, motor vehicle registration numbers, identity card numbers and telephone numbers is correct. We had pointed out this necessity in our own original assessment of the system.

The issue of foreign exchange

An important issue that has been completely ignored in the new legislation is the issue of assets and liabilities the values of which are denominated in foreign currencies (i.e. in currencies other than the €, in which the Wealth Statements must be drawn up and filed). In today's era of free (and

entirely legal) movement of capital outside of Cyprus, it is normal and expected that certain assets and liabilities will be denominated in foreign currencies, resulting in a change in the reported net assets (expressed in €) merely as a result of the fluctuations of the exchange rate of the affected currencies, despite the fact that there has been no change in the net assets, expressed in the foreign currency. This problem will be readily understood by the “uninitiated” reader by setting out the following simple example: The total net assets, as at 31 December 2023 and 31 December 2024 amounted to $1,000,000 deposited in a foreign bank account. The corresponding exchange rate on 31 December 2023 was €1=$1.11 and on 31 December 2024 it was €1=$1.03. Therefore, this asset, expressed in €, at 31 December 2023 was €900.900,90, while at 31 December 2024 it was €970,873.79, i.e. the asset expressed in € increased by €69.972,89, which represents a foreign exchange gain. This profit is entirely legitimate and must be reflected in the "Statements of Wealth" in order to achieve the anticipated equalisation. In the newly introduced legislation this issue was also ignored.

In practice, the reference date of Wealth Statements can be no other than 31 December

The bridging (or “reconciling") of two consecutive Wealth Statements is practically impossible, if the reference dates of the Wealth Statements are other than 31 December. The difficulty arises from the fact that the income declarations and the relevant certificates of employers, banks and all the other parties involved in the quantification of assets, liabilities, income and expenses to be reported are made with a reference date that is the 31 December of each calendar year. It is obvious that the legislator's specification of any other date raises insurmountable practical and theoretical problems. For example, no employer or bank can (and certainly will not want to) issue two certificates for a specific calendar year (for each family member), breaking the calendar year into two periods – a period from 1 January to the previous day of the day on which the politically exposed person takes office, and a second period, from the day of taking office until the end of the calendar year.

In addition to this practical difficulty, which is bound to cause serious inconvenience and cost, there is also the philosophical problem of how do you divide an income or expense item (quantified on an annual basis) into two components? And what if the bribe is collected from the politically exposed person (or his/her spouse or their dependents) the day before taking office or the day after their resignation?

The solution we had proposed in the past (but has been ignored) was to compile the Wealth Statements on an annual calendar basis, so that the "measured" period would coincide with that of the annual tax returns, covering the periods from 1 January of the year of assumption of the position until 31 December of the year of the loss of the position. Such an approach will have the added great advantage that all the Statements of Wealth filed will be coterminous (will have the same reference period), the same filing deadline and the same publication date, making the task of "managing" the declarations, but also the task of comparatively evaluating the returns by the journalists, other commentators and the civil society, in general, infinitely easier.

The compilation, the "bridging", the filing and the publication of the Wealth Statements of the politically exposed persons on an annual calendar basis undoubtedly makes the whole task easier (than drafting them on a longer time basis). The annual calendar base has the added great advantage of substantially increasing the chances of an early detection of illegal acts and of expediting the consequent removal of the perpetrators of these crimes from the political scene, thus limiting the damage they can cause.

Conclusion

On the basis of the concerns that are set out in this study, combined with concerns of lesser importance not mentioned here, we believe that the new system of "Wealth Statements" of the politically exposed persons will prove ineffective, like the previous systems that were in place for twenty years (from 2004 to 2024). Corruption and collusion undermine democracy and the ability of the state to judge and act solely on the basis of the interest of society as a whole. This capacity is of enormous importance when the very survival of the state is threatened, as is currently the case in Cyprus. We, therefore, call on all politicians and senior public servants to rise to the occasion and make the necessary legislative amendments to finally make the Cyprus "Wealth Statements" functional and fit for their intended purpose.

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